Internationalization, Related Party Transactions, and Firm Ownership Structure: Empirical Evidence from an Emerging Market

ABSTRACT

This study seeks to understand the adverse impact of related party transactions (RPTs) on the internationalization of emerging economy firms. The study further explores how a firm's ownership structure moderates the relationship between RPT and internationalization. Based on a sample of 367 Indian manufacturing firms, the study finds that RPTs have a negative influence on internationalization. Business group ownership is found to strengthen the negative relationship between RPTs and internationalization, whereas foreign shareholding weakens this relationship.

Key words: Emerging market, related party transaction, internationalization, ownership structure

1. Introduction

With the increase in liberalization and lowering of trade barriers, emerging market firms (EMFs) are internationalizing at a faster pace (Nair et al., 2015). According to UNCTAD, the outflow of foreign direct investment (FDI) from developing economies to developed economies has increased from 12 percent in 2000 to 39 percent in 2014 (UNCTAD, 2014). Although there has been considerable research on the determinants of EMF internationalization (Gaur et al., 2014; Peng et al., 2008; Sahaym and Nam, 2013), with increasing focus on firms' governance characteristics (Arregle et al., 2015; Lien et al., 2005; Majocchi and Strange, 2012; Pan et al., 2014; Pukall and Calabrò, 2014), the role of related party transactions (RPTs) remains largely unexplored (Liu and Ooi 2018). Given that corporate governance attributes have significant effects on internationalization (Calabrò et al., 2013; Strange et al., 2009), exploring the impact of RPTs is also essential.

Based on these gaps, the present study has two objectives. First, it will examine the impact of RPTs on EMF internationalization. Second, we explore how ownership structure could enhance or dampen the adverse effects of RPTs on internationalization. Thus, we explore how business groups (BGs) and foreign investors' shareholding influences the relationship between RPTs and internationalization.

RPTs can be defined as the transfer of resources from a focal firm or any of its subsidiaries to a related party (Jiang et al., 2010). "Related party" refers to controlling shareholders, directors, or any group that can influence the company, such as affiliates, subsidiaries, joint ventures, or other firms interrelated through the common ownership of the focal firm's controlling shareholders. This transfer, generally referred to as "tunneling," takes place through cash

injections, credit provision, or debt guarantees (Chang and Hong, 2000; Chung et al., 2004; Friedman et al., 2003; Jiang et al., 2010).

We specifically assert that since RPTs are generally associated with accounting fraud (Henry et al., 2007) and misappropriation of value for minority shareholders (Huyghebaert and Wang, 2012; Bona-Sanchez et al., 2017), they are considered a negative aspect of corporate governance (Lo et al., 2010; Ho and Wong, 2001). As poor corporate governance practices adversely impact internationalization (Sanders and Carpenter, 1998), RPTs also act as deterrents to internationalization. This is especially likely to be true for EMFs as they suffer from *liability of emergingness* (LOE) (Zhou, 2013). LOE explains the additional disadvantage that firms from emerging markets suffer for belonging to emerging rather than developed markets, which decreases their legitimation among stakeholders. RPTs signal potential fraud and weak corporate governance, so when firms from emerging markets internationalize with high RPTs, their legitimacy decreases, and barriers to internationalization are enhanced. We further assert that the impact of RPTs on internationalization is contingent on the ownership structure of the firm.

One unique characteristic of some emerging markets, such as India, is the presence of BGs (Douma et al., 2006). BGs have a tendency to tunnel money from a growing business to a poorly performing business through RPTs (Jia et al., 2013; Kali and Sarkar, 2011). As the group's ownership concentration in a business increases, they have more incentives to use RPTs inappropriately, at the cost of the interest of minority shareholders. Firms incurring RPTs are not seen in a positive light (Kohlbeck and Mayhew, 2010), and a high ownership concentration is likely to make this effect even stronger, resulting in more hindrances to internationalization.

Foreign investors, on the contrary, can dampen the negative impact of RPTs on internationalization, as they are often associated with improved corporate governance (Aggarwal

et al., 2011; Humphery-Jenner and Suchard, 2013). Thus, if RPTs occur in the presence of foreign investors, they are likely to be considered efficiency enhancing tools. This implies that as the ownership concentration of foreign investors increases, the adverse impact of RPTs on internationalization is likely to decrease.

Based on a sample of 367 Indian manufacturing firms, we find evidence in support of these hypotheses. As predicted, RPTs negatively influenced internationalization. The ownership concentration of BGs and foreign investors moderated the relationship such that with an increase in the ownership concentration of BGs, the negative impact of RPTs on internationalization increased, and with an increase in foreign investors' ownership, the negative impact of RPTs on internationalization decreased.

Our study contributes to the ongoing research about internationalization and corporate governance in emerging markets in three ways. First, to the best of our knowledge, this is the first empirical study on the impact of RPTs on firms' internationalization. Extant literature has explored RPTs and their impact on firms' performance outcomes (Kohlbeck and Mayhew, 2010). Our findings indicate that RPTs not only influence performance outcomes, but can also significantly affect firms' strategic decisions, such as the decision to internationalize. Our second contribution is to the business group literature on emerging markets. Evidence on the effectiveness of BGs in emerging markets has been mixed, with some scholars suggesting such groups are parasites or value destroyers, while others consider them paragons (Khanna and Yafeh, 2007; Tajeddin and Carney, 2018). In the context of RPTs, BGs have been found to have both a tunneling and a propping effect (Bae et al., 2002; Bertrand et al., 2002). We resolve this dilemma of the dual roles of BGs by exploring the impact of ownership concentration in focal firms, rather than merely the group affiliation that extant literature has largely focused on (Chari, 2013; Fisman and Wang,

2010; Iona et al., 2013; Kim, 2009; Kim and Song, 2017; Nekhili and Cherif, 2011; Gaur and Kumar, 2009; Gaur et al., 2014; Singh and Gaur, 2013).

Studies that have explored the ownership concentration of BGs have investigated the groups' direct impact on internationalization (Bhaumik et al., 2010; Majocchi and Strange, 2012; Ray et al., 2018) rather than the moderating effects. Our study thus deviates from previous studies and explains how the ownership concentration of BGs in a focal firm creates a boundary condition, especially in the context of the relationship between RPTs and internationalization.

Third, we contribute to the literature on internationalization of emerging markets by exploring contingent effects of the ownership concentration of foreign investors. EMF internationalization is challenging due to LOE and liability of foreignness (LOF) (Bangara et al., 2012; Madhok and Keyhani, 2012). In this context, we explain the role of foreign investors in limiting the negative impact of RPTs on internationalization.

This paper proceeds as follows. We present the extant literature on RPTs and internationalization and develop our hypotheses in Section 2, followed by the methodology in Section 3 and the results in Section 4. Finally, we present our discussion and conclusion in Section 5.

2.0 Literature review and hypothesis development

2.1 Internationalization of EMFs

Internationalization augments the agency problem, as the management team requires increased levels of discretion. This raises the need for appropriate corporate governance arrangements to ensure alignment between management and shareholders' interests. Despite the significance of corporate governance factors for internationalization, a relatively scant stream of literature has explored different governance factors that could influence internationalization.

Sanders et al. (1998) found that as internationalization required greater information processing and knowledge of international markets, and Barroso et al. (2011) emphasized the role of board traits on internationalization.

Among corporate governance factors, the role of family ownership and management in influencing the internationalization of EMFs has been widely studied (Chittoor et al., 2015). Leveraging the agency theory, scholars have explained how heterogeneity in the ownership structures and concentration of family firms influences firms' internationalization strategies (Ray et al., 2018). Singh and Delios (2017) reported that EMFs with higher percentages of independent board members and CEO duality were more likely to internationalize than peer firms. Similarly, Singh and Gaur (2013) reported the positive influence of group affiliation and family ownership on EMF internationalization. Although several governance factors have been explored in the context of internationalization, the impact of RPTs, which are a common phenomenon in emerging markets (Cheung et al., 2009), has not been investigated.

2.2 RPTs and their outcomes

The effectiveness of RPTs has been broadly examined under two theories, *efficient transaction hypothesis theory* and *conflict of interest theory*, with the former promoting the positive impact of RPT on firms and the later citing adverse effects of RPT (Pizzo, 2013). According to the efficiency hypothesis theory, RPTs could help firms reduce their transaction costs, respond to environmental uncertainties, enforce optimal contracts, and enhance efficiency through deeper knowledge of related parties, which is not possible when relationships with parties are kept at arm's length (Coase, 1937; Pizzo, 2013; Williamson, 1988).

Conflict of interest theory, on the contrary, suggests that through RPTs, firms can use their power to expropriate wealth for personal gains (Boateng et al., 2017). This opportunistic behavior

among related parties could increase agency costs and reduce the wealth of other stakeholders. RPTs could also potentially violate the arm's-length relations that are assumed in regular market-based transactions. This impairs the representational faithfulness and verifiability of financial statements and performance claims by firms (Habib et al., 2015).

The adverse impact of RPTs, as predicted by conflict of interest theory, has been widely reported in the finance literature. For instance, La Porta et al., (2000) found that related party lending was a manifestation of looting. Cheung et al. (2009) mentioned that RPTs led to the erosion of shareholders' wealth. Claessens et al. (2002) and Downs et al. (2016) observed that large controlling shareholders were able to channel corporate resources towards projects that generally benefitted controlling owners but not necessarily minority owners; this also dampened firms' market valuation (Cherif, 2017; Moscariello, 2012; Nekhili and Cherif, 2011). Firms that engaged in RPTs were also more likely to engage in financial misstatement (Kohlbeck and Mayhew, 2017), although this varied with the type of RPTs (Fang et al., 2018).

Given the financial casualties associated with RPTs predicted by the conflict of interest theory, RPT is considered a suspicious corporate activity by stakeholders (Chen and Chein, 2007). It is generally seen as more of a manipulative than value-enhancing tool (Lo and Wong, 2016), thus signaling poor corporate governance.

2.3 RPTs and internationalization of EMFs

In emerging markets, human capital and financial markets are not well-developed. They also suffer from weak legal and regulatory markets. All this gives rise to institutional voids (Khanna and Palepu, 2000). Consequently, most family firms exist as BGs, which substitute the imperfect markets and voids with their internal capital markets. A "business group" refers to a set of family firms that are legally independent but bound together through a network of formal and

informal ties among the families who own these firms as the corporate parent (Khanna and Rivkin, 2001; Yiu et al., 2005).

These business groups are resource-rich and have internal capital markets that they use to allocate capital among member firms. Although allocation of capital from internal markets may benefit member firms to whom capital has been allocated, it may not reflect the most efficient form of capital allocation among member firms (Almeida et al., 2015). This is because resources are generally transferred from financially well-performing firms to poorly performing firms, which may or may not have the capability to improve their performance (Stein, 1997). For instance, researchers have found that in China, controlling shareholders used RPTs to extract resources for personal benefit (tunneling), leaving minority shareholders at a disadvantage due to the transfer of resources to inefficient firms (Cheung et al., 2006; Jian and Wong, 2010; Jiang et al., 2010; Peng et al., 2010).

This, accompanied by other adverse effects, makes an RPT likely to be perceived by stakeholders, such as creditors, lenders, and capital markets, as a tool for misappropriation of resources (Jiang et al., 2010; Khanna and Palepu, 2000). Overall, in an institutional context where internal capital markets exist and investor rights are only weakly protected, RPT is likely to signal poor corporate governance, thus adversely influencing firm internationalization.

As firms internationalize, it is necessary for them to legitimize their expansion in host countries (Ramachandran and Pant, 2010). Legitimacy of a firm in a host country is often determined by its organizational image, how the organization is perceived by the relevant outside stakeholders (Dutton et al., 1994). This image is determined in part by the firm's corporate governance practices (Pólos et al., 2002); poor governance norms, such as RPTs, adversely

influence the firm's legitimacy in the eyes of stakeholders in host countries (Zuckerman, 1999; Bear et al., 2010).

As RPTs are associated with fraudulent financial reporting, diminished firm value, and so on, stakeholders may consider firms indulging in RPTs illegitimate and therefore reduce the firm's credit-worthiness and implement stringent lending norms (Ashbaugh-Skaife et al., 2006). This could dampen a firm's ability to raise capital, especially for risky ventures such as internationalization (Barkema and Drogendijk, 2007). The adverse effects of illegitimation arising from RPTs, are likely to be even higher for EMFs than for firms in developed markets, as they suffer from LOE (Ramachandran and Pant, 2010). This liability arises out of the poorly developed financial markets and institutional voids in these countries, which raise the risk and volatility associated with emerging markets. Because of poor institutional environments and weak legal protection for investors, it is often believed that emerging markets have poor corporate governance practices (Bell et al., 2014). BG firms' investment in RPTs is likely to aggravate this negative perception, because inefficient usage of internal capital markets and associated deterioration in firms' value makes access to capital resources even more difficult for internationalization. Regarding emerging markets, Ghemawat (2007) stated, "The country of origin matters—even for capital, which is often considered stateless" (p. 143). Thus, RPTs hinder internationalization for BG firms by enhancing the inhibitions of creditors as well as external agencies, such as credit rating agencies and regulators; poor corporate governance and illegitimation thus make access to capital and international markets difficult. Hence, we hypothesize:

Hypothesis 1. RPTs negatively influence internationalization for EMFs.

2.4 Moderating role of shareholding percentage of business group family members

The degree of family ownership influences BGs' ability to exercise their controlling rights and influence a firm's strategic direction, such as internationalization (Ray et al., 2018). Agency theory asserts that with increasing ownership, the risk propensity of owners decreases (Beatty and Zajac, 1994; Denis et al., 1997). When family members of a BG have a high ownership concentration, they bear a significant amount of socio-emotional wealth associated with the firm, which discourages them from taking any risky initiatives, such as internationalization, even if the initiative implies better financial returns (George et al., 2005; Liu et al., 2011).

Internationalization involves significant risk-taking, especially for emerging-market firms, as their extant experience in managing operations overseas has been negligible due to a closed economy. With concentrated ownership, this adverse influence on internationalization is likely to be higher, as family members of BGs have little incentive to create value for minority shareholders by taking risky initiatives. Extant literature supports this risk-averse behavior of firms with concentrated family ownership toward strategic moves such as internationalization (García -Marco and Robles-Fernandez, 2008). As ownership concentration of BG family members increases, BGs invest in developing resources that pertain to the institutional framework of the home country, thus keeping them location bound, further distracting them from developing internationally transferable resources and diminishing the ability to internationalize (Tan and Meyer, 2010).

Apart from this, BG firms are hesitant to subject themselves to the scrutiny of external regulators, investors, creditors, and other stakeholders, which is required to complete due diligence processes and make capital markets accessible for internationalization (Bhaumik et al., 2010). To date, only the direct impact of ownership concentration of BGs has been examined in the

international business literature. We assert that it can influence other governance factors, such as RPTs, on internationalization as well.

BGs, by virtue of their internal capital markets, have the ability to indulge in RPTs. The extent to which misappropriation takes place depends on the ownership concentration of BG family members in focal firms from whom resources are likely to be misappropriated. A prominent view in the finance literature based on agency theory asserts the "tunneling role" of BGs, wherein minority shareholders are expropriated and resources diversified to the advantage of controlling shareholders (Jiang et al., 2010). The tunneling effect is likely to be higher with an increased ownership concentration of BG family members.

Recently, scholars have advanced a coinsurance view of RPTs, where tunneling effects co-exist with propping effects, the welfare-enhancing effects of BGs (Fisman and Wang, 2010). Given the fraudulent activities associated with RPTs (Louwers et al., 2008), with increasing ownership concentration of a BG in a focal firm, the illegitimating effects of RPT on internationalization are likely to increase. In a weak institutional environment, BGs would have incentives for opportunistic earnings management through RPTs and thus indulge in negative governance practices, an effect likely to increase with their ownership concentration. (Kim and Yi, 2006). Extant literature also reveals that a firm's market valuation deteriorates with an increase in ownership concentration after majority shareholders indulge in manipulative financial practices to maximize their compensation (Douma et al., 2006).

Overall, with an increasing ownership concentration of family members of a business group, in emerging markets, where investor rights are only poorly protected, due to enhanced misappropriation of shareholders' wealth, RPTs are likely to illegitimatize a firm's image for

stakeholders, further constraining resources for internationalization and adversely impacting the firm's ability to internationalize. Hence, we hypothesize:

Hypothesis 2. The concentration of family ownership in a BG moderates the relationship between RPTs and internationalization, such that when family ownership concentration is high, there is a greater decrease in internationalization associated with the increase in RPTs than when family ownership concentration is low.

2.5 Moderating role of shareholding of foreign investors

External investors, such as institutional investors from banks, investment firms, or venture capital firms, play a critical role in monitoring managers and suggesting strategic actions, which influences a firm's governance and performance in several ways. First, economic goals are pursued more aggressively by top management due to performance pressure from these investors (Nashier and Gupta, 2016). Second, through voting as a governance tool, investors punish errant managers (Mallin, 2012). Third, through shareholder activism, they influence the firm's strategic decisions (Gillan and Starks, 2003). Fourth, the firm's resource position is augmented by virtue of the tacit and explicit knowledge that these investors bring from their diverse networks (Zhou et al., 2016). Consequently, investors can influence the firm's internationalization (George et al., 2005; Humphery- Jenner and Suchard, 2013).

Foreign investors have been found to positively influence internationalization (Cerrato and Piva, 2012; Douma et al., 2006; Gül et al., 2010; Tainio et al., 2001), particularly that of EMFs (Hoskisson et al., 2000; Humphery- Jenner and Suchard, 2013). Foreign ownership imparts a greater knowledge of the international environment and is indicative of a wider view of markets (Fernández and Nieto, 2006). Foreign investors encourage high-risk (Markowitz, 1991), high-commitment internationalization decisions (Filatotchev et al., 2008; Strange et al., 2009), as they

have incentive to sell their stakes unless the firms in which they have invested sustain capital market gains. Since internationalization generally leads to increases in stock prices (Gubbi et al., 2010), foreign investors are likely to motivate firms to undertake foreign expansions.

Foreign institutional investors (FIIs) from developed market economies may afford EMFs access to a global pool of financial resources. FIIs are also experienced in coping with opportunistic behavior and have an in-depth understanding of risk/return relationships in international cultural settings (Thomsen and Pedersen, 2000). For instance, if internationalization requires considerable capital outlays to establish foreign operations, and further payoff from such investments is uncertain, FIIs with greater understanding of the risk/benefit trade- offs in the global context could positively influence internationalization outcomes. Drawing on their global investment experiences, FIIs can provide family firms access to strategic expertise and knowledge to help them expand internationally (Tihanyi et al., 2003), particularly through the outflow of FDI.

If firms have a high level of investment by FIIs, they are likely to have frequent and deep engagement with FII representatives, which could enhance new knowledge creation, thus overcoming the regional orientation and strategic stagnation of focal firms (Miller et al., 2008). A greater presence of foreign ownership helps firms improve their understanding of international markets, minimize the fear of the unknown, and avail themselves of the benefits of internationalization.

The strategic role of foreign investors in the internationalization of EMFs is well established (Chittoor et al., 2015; Douma et al., 2006; Filatotchev et al., 2008). As EMFs internationalize, they may experience challenges posed by institutional differences, such as the liabilities of foreignness, emergingness, and newness (Bangara et al., 2012). EMFs may lack technological and international marketing capabilities, which are vital to compete in global

markets (Stucchi, 2012; Yiu et al., 2005). EMFs can mitigate these problems by finding appropriate partners in international markets, leveraging the network resources of foreign investors (Fernández and Nieto, 2006). Regular contact with FIIs can also facilitate access to intermediaries, such as investment bankers or legal experts and consultants. This community of professionals who are conversant with the international assets market could further help EMFs be more informed about the risks and benefits of internationalization, the availability of various avenues for financial support, and so on. This alters risk perceptions about the internationalization of EMFs (Carpenter et al., 2003, p. 806).

Furthermore, foreign investors have superior monitoring abilities and induce transparency in firms. Although RPTs are generally associated with opportunistic earnings management and tunneling, firms can utilize a high volume of such transactions without engaging in any accounting or financial fraud (Wong et al., 2015). Under certain contingencies, RPTs could enhance a firm's operating efficiency. Some companies, by investing in joint ventures, obtain faster access to supplies or markets and thus reduce business risk (Kohlbeck and Mayhew, 2010). This is the reason that no country prohibits the use of RPTs (Djankov et al., 2008). This implies that if RPTs are governed properly, they can be beneficial for firms and even enhance the internationalization of firms. We assert that foreign investors could be beneficial to this end, decreasing the negative impact of RPTs on internationalization. Improving overall governance practices enhances an EMF's reputation and credibility in international markets, even in the presence of RPTs, thus diminishing RPTs' adverse impact on internationalization. Hence, as foreign investors' equity ownership in EMFs increases, the impact of RPTs on internationalization decreases. We hypothesize:

Hypothesis 3. Equity ownership by foreign investors moderates the relationship between RPTs and internationalization, so that when the concentration of foreign ownership is greater, the decrease in internationalization associated with an increase in RPTs is less than when foreign ownership is low.

The conceptual framework of this study is presented in Figure 1 below:

Insert Figure 1 about here

3.0 Methodology

3.1 Sample

India provides an interesting platform to explore drivers of internationalization because of the unique history of the internationalization of Indian firms. Internationalization gained pace in India when the country faced a severe balance-of-payments crisis in 1991. At that time, India had foreign reserves that could support the import of goods for only two weeks. Consequently, the government realized that structural changes in the economy were required (Popli and Sinha, 2014). These structural changes included opening the economy and letting multinationals flock to India through foreign direct investment. To survive the competition, some Indian firms responded by internationalizing, while others attempted to save their weak business divisions by diverting increasingly more money into them. India is also an interesting environment for study because it is an emerging market (Hoskisson et al., 2000) in which corporate parents, like BGs, are more prominent than in any other country (Khanna and Palepu, 2010), thus providing a rich platform for exploring the effect of RPTs. Finally, research on internationalization in emerging markets has

been largely biased towards China, with comparatively less attention given to other countries (Jormanainen and Koveshnikov, 2012). These factors make India an important and informative setting in which to explore internationalization drivers.

Our sample consisted of manufacturing sector firms in India. The Indian manufacturing sector is a good setting for studying internationalization, as the manufacturing sector is a key driver of the Indian economy. We focused on nine years of data (2005–2014); it was difficult to obtain annual reports of firms prior to this period from archival sources.

We first examined all firms listed in the manufacturing sector of Prowess, a financial database of Indian firms, which resulted in a population of 11,030 firms. Following the approach of Elango and Patnaik (2007), we restricted our sample size to only those firms that exhibited average sales of at least $1,000,000 in the given time frame, 2005–2014. Firms beyond this sales level can be safely assumed to be larger and more likely to internationalize than firms under this level (Dass, 2000). We eliminated firms that were subsidiaries of multinational firms, were non-group affiliated, or had missing values for financial metrics that we used in the paper. Prowess provides an option of segregating business group firms from stand-alone or private foreign firms; firms are explicitly labeled as stand-alone private, foreign, state government, or BG-owned. We focused on BG-affiliated firms only, as RPTs are most commonly seen in BG-affiliated firms. After filtering the data according to these parameters, we were left with a sample of 367 firms.

3.2 Dependent variable operationalization

We measured the internationalization of the focal firm as the ratio of foreign investments to total investment of the firm (Bhaumik et al., 2010; Chari, 2013). Here, foreign investments refer to foreign direct investments, and information on these is available in Prowess. As the variable was skewed toward the left, an exponential operator was performed. Because of data limitations,

particularly in emerging economies like that of India, we could not obtain other measures for internationalization, such as the ratio of foreign employees to total employees or the ratio of foreign offices to total offices. Information on foreign investments and assets was obtained from Prowess.

3.3 Independent variable operationalization

RPTs. Items considered RPTs in the focal firm for each year were giving loans, advances, and bank guarantees; paying royalties and dividends; and investing in shares of the related parties. We included only these items to reflect the tunneling effect of RPTs. Information on RPTs was obtained from the firms' annual reports due to incomplete information in Prowess (Srinivasan, 2013). The transactions, as reflected in these items, were summed and divided by the total assets of the firm to interpret RPT in the context of firm size.

Family ownership concentration. To measure family ownership concentration, the percentage of family shareholding in a firm was obtained from Prowess.

Foreign ownership. Foreign ownership was represented by the sum of the percentage of foreign equity holding, including all foreign institutional investors, corporations, and individuals. This information was obtained from Prowess.

Interaction effect of RPTs and family ownership concentration. A mean-centering technique was used to reduce the chances of multicollinearity (Osborne, 2008). First, the averages of both RPTs and family ownership concentrations were calculated for the entire sample, and then these average values were respectively subtracted from the individual RPTs and family ownership values. These resulting values were then multiplied with each other.

Interaction effect of RPTs and foreign investor ownership. Using a mean-centering technique, the averages of RPTs and foreign ownership were first calculated for the entire sample,

and then each average value was respectively subtracted from the individual RPTs and foreign ownership values. These resulting values were then multiplied with each other.

3.4 Control variables

We controlled for size of the firm (Tihanyi et al., 2003), age of the firm (Gaur and Kumar, 2009), marketing and R&D intensity (Chari, 2013), leverage (Gaur et al., 2014), firms' past performance (Bhaumik et al., 2010), and industry effects. We measured firm size using the natural logarithm of total employees. We measured age of the firm by taking the natural log of the total number of years since the firm's inception. Marketing and R&D intensities were calculated as the ratio of marketing expenditure to sales and the ratio of R&D expenditure to sales, respectively. Leverage was measured as a debt-to-equity ratio (Bhaumik et al., 2010). Firms' past performance was captured with sales growth (Chittoor at al., 2009). To control for industry effects, we used dummy variables in the analyses, keeping the business-to-business firms as the base category and coding business-to-consumer industries as 1 (Chan et al., 2012).

3.5 Modeling procedure

As our data was panel in nature, we tested our hypotheses using generalized least square (GLS) models, which corrected for heteroskedasticity and autocorrelation. A Hausman test confirmed that we needed to use a random effect model. GLS was appropriate for random effect models because it produced residuals that estimated the unit-specific serial correction of the errors associated with panel data; thus, the model was transformed into one with serially independent errors (Beck and Katz, 1995; Greene, 2000). GLS also maximized the degree of freedom (Lee and Song, 2012). We use the statistical software Stata for the analysis. As our analysis involved interaction effects, we also calculated variance inflation factors (VIF) to check if multicollinearity

was a problem. VIF ranged from 1.24 to 3.26, indicating that multicollinearity was not a problem with our sample. Thus, we estimated the following model:

$$\text{Internationalization}_{i,t} = \alpha + \beta_1 \text{RPT}_{i,t-1} + \beta_{2,\,i,t-1}\,\text{BG Concentration}_{i,t-1} + \beta_{3,\,i,t-1}\text{Foreign Equity} + \beta_{4,\,i,t-1}\text{Firm Age} + \beta_{5,\,i,t-1}\text{Firm Size} + \beta_{6,\,i,t-1}\text{RPT*BG concentration} + \beta_{7,\,i,t-1}\text{RPT*Foreign Equity} + \beta_{8,\,i,t-1}\text{R*D Intensity} + \beta_{9,\,i,t-1}\text{Marekting Intensity} + \beta_{10,\,i,t-1}\,\text{Sales Growth} + \beta_{11,\,i,t-1}\,\text{Debt/Equity} + \beta_{12,}\,\text{i, Industry} + \text{Years control} + \varepsilon$$

4.0 Results

This section presents the empirical models that test our hypotheses related to the determinants of internationalization of Indian firms. Table 1 presents the descriptive statistics and correlations, and Table 2 presents the results of GLS regression.

Insert Table 1 about here

Insert Table 2 about here

From Table 1, it can be observed that average BG ownership in a focal firm was 45%, and foreign ownership was 11%. From a governance perspective, 45% of shareholding by BGs can be considered high, while 11% of foreign investor holding is low. The RPT-to-asset ratio was 0.025. The average marketing expenditure was 4%, while average R&D intensity was less than 1%.

Three models were tested in the present study, the results of which are presented in Table 2. In Model 1, which reports a baseline model, only control variables are included. The baseline model performs satisfactorily, with an R^2 value of 0.21. Control variables also performed in the expected manner. Large firms were positively associated with internationalization. Similarly, firms with higher R&D and marketing intensities were found to be positively associated with internationalization. However, we did not find any differences between business-to-business or business-to-consumer sectors.

In Model 2, we include the independent variables, which in our study are hypothesized to influence the internationalization of EMFs. Our first hypothesis stated that internationalization is negatively associated with RPTs. Since the beta coefficient of RPTs is negative and significant ($\beta = -0.14$, $p<0.001$), we receive evidence in support of the first hypothesis. Thus, firms that channel money to sister concerns through RPTs exhibit a lower preference for internationalization, indicating that firms with poor corporate governance are less likely to internationalize.

It was interesting to observe that with an increase in BG ownership concentration, internationalization decreased. Our second hypothesis predicted a moderating impact of family ownership concentration in a BG on the relationship between RPTs and internationalization. Our results indicate that the beta coefficient of the interaction between RPTs and family ownership concentration is significant ($\beta = -0.10$ $p<0.001$). Graphical representation of this interaction term is presented in Figure 2. As can be observed from Figure 2, when the ownership concentration is high, there is a greater decrease in internationalization associated with the increase in RPTs, compared to cases when the family ownership concentration is low. This implies that the concentrated ownership of family members enhances the negative impact of RPTs on internationalization. Thus, we receive evidence in support of our second hypothesis. This clearly

indicates that family members do not promote risky strategies, such as internationalization, and prefer to tunnel slack resources through RPTs.

Our third hypothesis predicted a moderating impact of foreign ownership on the relationship between RPTs and internationalization. Model 3 in Table 2 shows that the beta coefficient of the interaction term between foreign ownership and RPTs is statistically significant ($\beta = 0.12$, $p<0.001$). Graphical representation of this relationship is presented in Figure 3. As can be observed from Figure 3, when foreign ownership is high, there is a small decrease in internationalization associated with an increase in RPTs. When foreign ownership is low, there is a much higher decrease in internationalization associated with an increase in RPTs. Thus, we receive evidence in support of our third hypothesis. Our results clearly indicate that foreign investors prefer internationalization, which reduces the negative impact of RPTs on internationalization.

Insert Figure 2 about here

Insert Figure 3 about here

4.1 Robustness test

Although previous studies did not report RPT as an endogenous variable, in order to mitigate the possible endogeneity problem, we used a two-stage least square regression in Stata. In order to estimate an instrumental variables regression for panel data, an exogenous instrument

for RPT was required. Wooldridge (2008) suggested that a good instrument is one that is: (1) correlated with the endogenous independent variable, RPT in this case, and (2) uncorrelated with the error term. Industry- level RPT was a good instrument for the endogenous independent variable, as industry-level RPT could influence firm-level RPT, but it was unlikely to be correlated with the internationalization of the focal firm. Such industry-level exogenous instruments have been used in extant literature on emerging market firms as well (Chittoor et al., 2015). The beta coefficient of industry-level RPT was positive but insignificant, indicating that endogeneity was not an issue. Refer to table 3 for details.

We further sub-divided our group-affiliated sample of firms into firms associated with top 50, top 100, and other BGs, based on sales. We checked if the relationship between RPTs, moderators, and firm performance varied across different types of business groups. Overall, although significance levels differed, results remained significant. We lagged RPTs up to three years to check for sensitivity of the lag period. Although the beta coefficient and significance level changed, results remained qualitatively unchanged.

Insert Table 3 about here

5.0 Discussion and conclusion

Internationalization of firms from a governance perspective has recently received a great deal of attention (Bhaumik et al., 2010; Filatotchev et al., 2008; Mitter et al., 2014). Although the role of several governance factors, such as the board of directors, has been examined (Singla et al., 2014), RPTs have not received any attention in context of internationalization. Gordon et al. (2004)

stated that diverse and complex RPTs represented a corporate governance challenge, thus raising the importance of exploring the impact of RPTs on strategic outcomes, such as internationalization.

In this study, we examined the relationship between RPTs and EMF internationalization, as well as the moderating effect of a firm's ownership structure on the relationship between RPTs and internationalization. We expected that, due to several negative implications imposed by RPTs, there would be a negative relationship between RPTs and internationalization. We expected that family ownership in BG-affiliated firms would further enhance the negative relationship between RPTs and internationalization, whereas an increase in equity stakes by foreign investors would weaken the negative impact of RPTs on internationalization.

We found support for a negative relationship between RPTs and internationalization. This indicates that the impact of RPTs on a firm's strategic decisions is not different from their impact on other organizational outcomes, such as firm performance, which they have been found to adversely affect (Ryngaert and Thomas, 2012). RPTs were also found to adversely impact earnings management by firms (Jiang et al., 2010), CEO compensation (Balsam et al., 2017), earnings rate (Cho and Lim, 2018), and several other firm-level outcomes. On similar lines, we found that RPTs adversely influenced the internationalization of EMFs. The negative effect of RPTs on a firm's internationalization indicates that RPTs weaken the corporate governance system of the focal firm (Kohlbeck and Mayhew, 2017), which raises challenges for EMFs to internationalize. Although RPTs can sometimes benefit firms, they are considered a negative signal of corporate governance (Kohlbeck and Mayhew, 2010; Yeh et al., 2012); this can have an adverse impact on internationalization. Our results are consistent with the theory of internationalization in which governance factors have a significant impact on how firms manage their foreign direct investment (Hu and Cui, 2014; Singh and Gaur, 2013; Singla et al., 2014).

Our findings also show that the ownership structure of BGs influences the relationship between RPTs and internationalization, such that increased family ownership concentration in BGs amplifies the negative relationship. The ownership concentration of BGs has been found to negatively influence outgoing FDI (Filatotchev et al., 2008; Lin, 2012), international sales (Calabrò et al., 2017), international entrepreneurship (Sciascia et al., 2012), and organizational learning outcomes (Zahra, 2012). Our findings indicate that ownership concentration not only has a negative direct impact on firm outcomes such as internationalization, it even negatively moderates the impact of other governance variables, such as RPT, on internationalization. With regards to this negative moderating effect, our findings are in corroboration with extant studies where family ownership has been found to influence the relationships between R&D and CEO compensation (Tsao et al., 2015) and between entrepreneurial orientation and firm performance (Campbell et al., 2010), although direct evidence on the moderating effect of BGs is missing.

Our findings also indicate that exploring the role of BGs through affiliation rather than ownership structure can yield different results. Some studies indicate a positive impact of BG affiliation on internationalization, while others report a negative impact (Chari, 2013; Iona et al., 2013; Kim and Song, 2016; Singh and Gaur, 2009). This difference in findings may have occurred because we considered shareholding structure rather than mere group affiliation. It is interesting to see that although BGs can provide intangible network resources to affiliated firms for internationalization (Elango and Patnaik, 2007; Gubbi et al., 2010; Yiu et al., 2005), RPTs can void the benefits of intangible resources of BG-affiliated firms, as firms are unable to internationalize or only able to internationalize to a lesser extent due to heighted LOE or LOF.

Unlike family members in BGs, foreign equity investors prefer internationalization, as they have potential resources that can help in expanding overseas. They can help reduce LOE by

providing network resources in international markets. Despite poor protection of the rights of minority investors, foreign investors, through active monitoring mechanisms, diminish the negative impact that RPTs can have on internationalization. This may happen because foreign investors are able to leverage their international networks to raise external funding and reduce operational risks in international markets by providing critical informational resources. In this way, our findings are consistent with extant literature showing that high foreign equity ownership among Indian firms was associated with a higher propensity for internationalization (Chittoor et al., 2015; Bhaumik et al., 2010; Elango and Pattnaik, 2007). However, our findings contrast with the role of foreign investors in developed markets, where these investors were found to be less involved in the governance aspect of firms (Kang et al., 2010). Refer to table 4 for summary of results.

Insert Table 4 about here

Our findings are consistent with extant literature, where governance traits, such as board independence or family ownership, were found to moderate the relationship between RPTs and firm performance (Aswadi et al., 2011). We found a moderating impact of other governance traits, the ownership structure of a firm and its impact on the RPT/internationalization relationship.

Overall, we found support for our hypothesis on the impact of RPTs on a firm's internationalization under the boundary conditions of the firm's BG and foreign investors' ownership. Our findings indicate that RPTs, especially in emerging markets, can be a significant inhibitor of internationalization. Additionally, our study points to a need to explore this

relationship in other emerging markets as well. Given the developing nature of theory for emerging markets, replication of this study in a different country context might produce different results. The conflicts between foreign investors and family owners in a BG reflect differences in perception and interest, such as risk-averse behavior vs. risk-taking behavior. Internationalization and corporate governance literature can be further enriched by directly exploring why these differences in behavior exist. Finally, the scant literature on EMFs and the uniqueness of the governance characteristics in these markets make the findings of our study interesting.

This study has several limitations as well. The study is based on a sample of Indian firms, which limits the generalizability of our findings to other contexts. Future studies should explore this relationship in other emerging economies. Additionally, we tested for only one factor, ownership structure, which might affect the relationship between RPTs and internationalization. Future studies could consider other context-specific factors, such as the home country's institutional and cultural environments. One possible approach to incorporating these factors could be to conduct case studies on a few firms to qualitatively analyze the impact of different institutional and cultural contexts on the performance of internationalizing firms. We also assert that RPTs impact internationalization through capital markets.

We acknowledge that there could be significant variance across sectors. This is a potential weakness of our study, in that it limits the external validity of our results. Future studies should address this limitation by analyzing the relationship between RPTs and internationalization for specific sectors. Given that certain sectors in emerging economies, such as computer software and pharmaceuticals, have gained far greater international prominence than other sectors, it is likely that the relationship between RPTs and internationalization is different in different sectors. We assume, based on resource dependency theory, that RPTs result in resource scarcity that cannot be

fulfilled by either internal or external capital markets. However, testing mechanisms through which RPTs shape resource availability were beyond the scope of this study and are hence a limitation of the study. We did not segregate different types of RPTs to explore their impact on internationalization, although extant literature in finance and accounting indicates that not all RPTs are disadvantageous for firms (Fang et al., 2018).

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Table 1- Descriptive Statistics and Correlation Matrix

		Mean	S.D	1	2	3	4	5	6	7
1	International Diversification (exponential form)	1.02	0.13	1						
2	RPT/Asset	0.025	1.36	− 0.20***	1					
3	Ownership Concentration (of Family Members)	0.45	1.23	-0.17**	0.12***	1				
4	Foreign Ownership	0.11	0.32	0.24***	-0.11***	-0.12***	1			
5	Firm Size	8.07	9.15	0.10*	0.10***	0.001	0.04***	1		
6	Firm Age	3.72	0.89	0.002	0.001	0.002	0.02	0.06***	1	
7	Marketing Intensity	0.04	0.06	0.010***	0.01	0.08***	0.10***	0.07***	0.002	1
8	R&D intensity	0.00	0.021	0.01	0.00	0.03**	0.05***	0.03**	0.005	0.00
9	Debt to Equity	1.28	2.45	0.004	-0.04**	0.06***	0.01	0.09***	0.07***	0.00
10	Past performance	2.47	5.89	0.12***	0.08***	0.07***	0.06***	0.11***	0.00	0.04

***, p<.000; **, p<.01; *, p<.05;

Table 2

Multiple Linear Regression Results of Impact of RPT on International Diversification

Dependent Variable: International Diversification	Model 1	Model 2	Model 3
RPT		− 0.14*** (0.04)	− 0.15*** (0.05)
Ownership Concentration (of Family Members)		-0.08** (0.03)	-0.10* (0.04)
Foreign Ownership		0.11*** (0.03)	0.13*** (0.04)
RPT*Ownership Concentration (of Family Members)			-0.10*** (0.03)
RPT* Foreign Ownership			0.12*** (0.04)
Firm Size	0.07*** (0.02)	0.08 ** (0.3	0.09** (0.04)
Firm Age	0.02 (0.08)	0.03 (0.09)	0.01 (0.010)
Marketing Intensity	1.12* (0.49)	1.16* * (0.54)	1.19** (0.56)
R&D Intensity	0.71** (0.24)	0.73** (0.25)	0.75** (0.28)

Industry	0.13 (0.08)	0.12 (0.07)	0.12 (0.09)
Debt Equity Ratio	0.16 (0.12)	0.18 (0.12)	0.18 (0.13)
Past Performance	0.23** (0.08)	0.21* (0.10)	0.19* (0.09)
R2	0.21	0.24	0.26
Observations	3303	3303	3303

*** p<.001; ** p<.01; * p<0.05 s.e. are in parentheses

Table 3: Result of Instrumental variable Regression

Dependent Variable: International Diversification	Model 1	Model 2
Industry RPT	0.74 (0.45)	
RPT		− 0.11*** (0.04)
Ownership Concentration (of Family Members)	-0.06* (0.03)	-0.09*** (0.03)
Foreign Ownership	0.10*** (0.03)	0.14*** (0.05)
RPT*Ownership Concentration (of Family Members)	-0.12*** (0.04)	-0.07*** (0.02)
RPT* Foreign Ownership	-0.11*** (0.03)	-0.13*** (0.04)
Firm Size	0.08 *** (0.02)	0.10 *** (0.03)
Firm Age	0.02 (0.01)	0.04 (0.03)
Marketing Intensity	0.98	0.81

	(0.42)	(0.23)
R&D Intensity	0.86* (0.32)	0.77** (0.29)
Industry	0.10 (0.09)	0.13 (0.08)
Debt Equity Ratio	0.18 (0.12)	0.14 (0.09)
Past Performance	0.24* (0.10)	0.20* (0.08)
R2		0.25
Observations	3303	3303

*** p<.001; ** p<.01, *p<0.05

Table 4: Summary of results

Hypothesis	Beta Value & Significance	Support/Rejection
Hypothesis 1	$\beta = -0.14$, $p<0.01$	Supported
Hypothesis 2	$\beta = -0.10$, $p<0.01$	Supported
Hypothesis 3	$\beta = 0.12$, $p<0.01$	Supported

Figure 1

Conceptual Framework

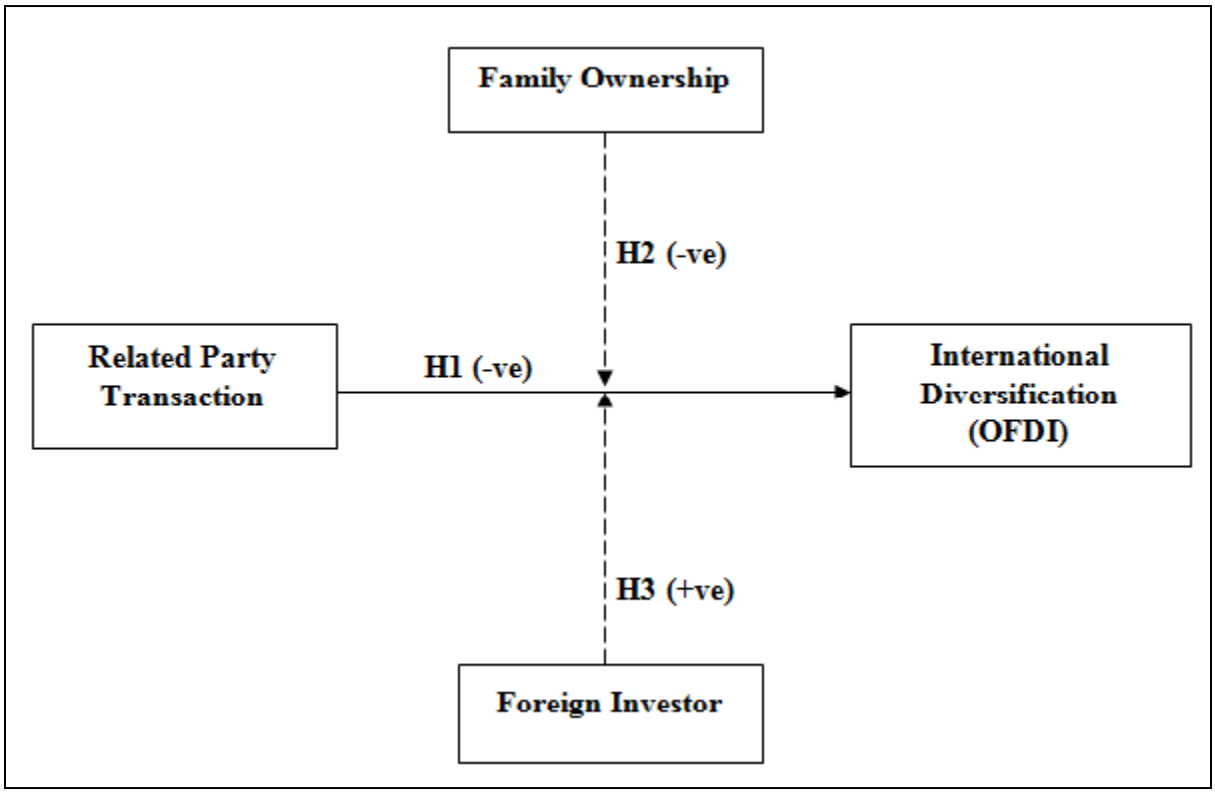

Figure 2

Moderating Impact of Ownership Concentration of Family Members on RPT and International Diversification

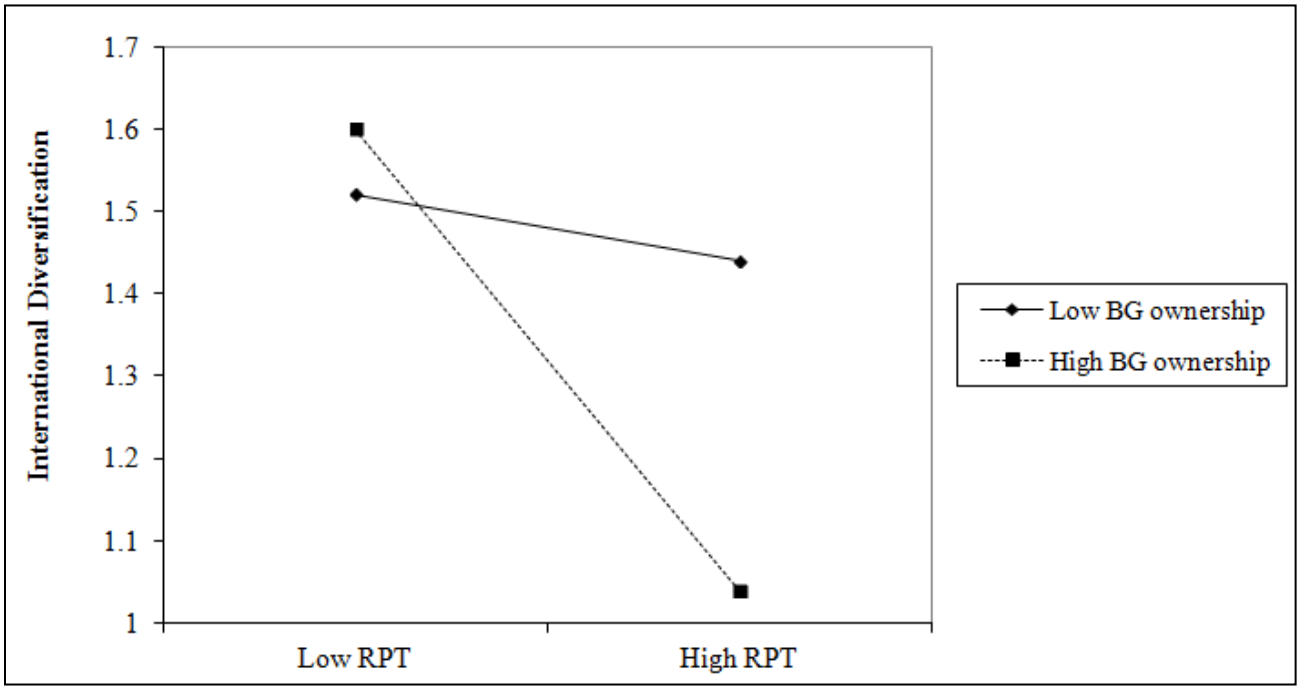

Figure 3

Moderating Impact of Foreign Ownership on RPT and International Diversification